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IN THE

Supreme Court of the United States

OCTOBER TERM, 1951.

No. 91

Fifty-eighth

58TH STREET PLAZA THEATRE, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No.

JEANNETTE BRECHER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, 58th Street Plaza Theatre, Inc., and Jeannette Brecher, hereby respectfully request this Honorable Court to issue writs of certiorari to the United States Court of Appeals for the Second Circuit to review the decision and judgments of that court entered in the above

entitled cases on March 18, 1952, pursuant to the majority opinion affirming the decision and orders of The Tax Court of the United States herein.

Opinions Below.

The findings of fact and opinion of the Tax Court (R. 106-118) are reported in 16 T. C. 468. The majority and dissenting opinions of the Court of Appeals (R. 139-144) have not yet been officially reported.

Jurisdiction.

The judgments of the Court of Appeals were entered on March 18, 1952 (R. 144-145). The jurisdiction of this Court is invoked under the provisions of 28 U. S. C. 1254.

Question Presented.

58th Street Plaza Theatre, Inc. (hereinafter sometimes referred to as "Plaza") held a lease on the Plaza Theatre at a rental of $30,000 per annum. On December 29, 1942, effective January 1, 1943, it sublet the theatre to Jeannette Brecher, the wife of its principal stockholder, by a sublease the provisions of which were scrupulously observed and pursuant to which she paid to Plaza a rental of $55,000 in 1943. Jeannette Brecher operated the theatre during the entire year 1943, and, as the Tax Court expressly found, "actually received the net income as her own and used it without restriction for her own purposes" (R. 116). Respondent allocated and taxed *all* of Jeannette Brecher's income from the theatre to Plaza, whose "only relation to the business in 1943 was that of sublessor of the building in which the sublessee operated the theatre" (R. 26, 143).

Respondent also taxed the income from the theatre, undiminished by corporate taxes thereon, to Jeannette Brecher as a dividend from Plaza (R. 40).

The question presented is whether a sublease of business property by a corporation to the wife of the controlling stockholder, pursuant to which the wife actually operated the property and received and retained the income therefrom, may in a collateral tax proceeding be disregarded as sham on the grounds (a) that the consideration to the corporation was less, according to the Tax Court, than could have been obtained in arm's length negotiations and (b) that the change from corporate to individual operation would reduce taxes.

Statutes Involved.

The pertinent statutory provisions are printed in the Appendix, *infra*, page 20.

Statement.

On December 29, 1942, Plaza subleased one of its two theatres to Jeannette Brecher for a term of five years commencing January 1, 1943, with provision for renewals (R. 110). Thereupon, Jeannette Brecher assumed and exercised proprietary dominion and control, *i.e.*, she opened a bank account in her trade name in which she deposited all of the box office receipts and from which she paid all of the theatre's expenses, she obtained a license from the City of New York to operate the theatre and Plaza surrendered its license, she secured transfer of the insurance policies on the theatre from Plaza, and entered into contracts for films in her trade name (R. 111). She

actively participated in the operation of the theatre and devoted considerable time to it (R. 111, 116).

Leo Brecher, principal stockholder of Plaza and husband of Jeannette Brecher, acted as manager of the Plaza Theatre both before and after the sublease, for which services he was paid a salary (R. 111).[1] His salary in 1943 from Jeannette Brecher was $6,000 (R. 111).

After payment of costs and expenses, including a rental of $55,000 required by the terms of the sublease, Jeannette Brecher had an income of $40,096.64 left for 1943 before payment of her income tax of $17,084.02 thereon as reported in her return (R. 40, 111). No part of that income was ever received by Leo Brecher or used to discharge any of his obligations (R. 111). Jeannette Brecher received this income as her own and used it without restriction for her own purposes (R. 116).

Leo Brecher owned a majority of the stock of Plaza at all times material to this proceeding and Jeannette Brecher owned 425 shares of such stock before January 4, 1943 and 25 shares thereafter (R. 110, 112). Their two children owned the remainder of the shares (R. 110).

The Tax Court concluded that the sublease was "bad business" *for Plaza* upon the basis of certain stipulated operating data from which the court inferred that Plaza could have obtained more at arm's length than the consideration fixed by the parties (R. 115-116). The court further concluded that prospective tax savings motivated the change from corporate to individual operation (R. 116).

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[1] Besides managing theatres for his own family corporation and his wife, Leo Brecher also managed theatres for outside investors who, however, did not participate in any way in the active operation of the theatres (R. 75). For these services he received 20% of the operating profits as compensation (R. 55, 75). He received approximately equivalent compensation for services relative to the Plaza Theatre (R. 85-86).

The Tax Court's holding that the sublease served no business purpose *of Plaza* implies that the purposes and motives of the parties are relevant. If so, it is pertinent to consider the purposes and motives of the Brechers individually. On this, it is clear, as noted by Judge Swan, that they *intended and carried out* the change from corporate to individual operation which was effected pursuant to the sublease.[2]

The Commissioner, in determining the deficiencies, held (1) that the income reported by Jeannette Brecher was additional income of Plaza, and (2) that such income was taxable also to Jeannette Brecher as a dividend from Plaza (R. 111-112). Accordingly, on the $40,000 of income in controversy, he asserted corporation taxes of $34,000 and individual taxes of $17,000—taxing all of the income, without reduction for Jeannette Brecher's tax thereon, to Plaza and taxing all of the income again, without reduction for

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[2] The evidence as to Jeannette Brecher's motives (the Tax Court's findings are silent on this) is uncontradicted: Her daughter was married in February, 1942, her son enlisted in the armed forces on December 7, 1942, her son-in-law was also in the military service, she testified that she had plenty of time and so returned to the theatre business (in which she had always been intensely interested, having been employed as a girl in a theatre office where she met her future husband) with a view to having an income of her own (R. 49, 74, 91, 98-99). Concerning Leo Brecher's motives, he testified that, fearing a possible heavy judgment against him from a pending suit, he was concerned lest his controlling stock in the family corporation fall into incompetent and hostile hands, with the result that the corporation's business would suffer, and that he was anxious to protect the interests of his children as stockholders (R. 69, 91). Although this testimony was uncontradicted, a footnote to the majority opinion of the Second Circuit below stated that Leo Brecher had more than adequate assets *in addition to his theatre company stock* to pay off any judgment that might be obtained against him. This assertion is not based on findings of the Tax Court and, in our opinion, is unsupported by the evidence.

Plaza's taxes thereon, to Jeannette Brecher (R. 17-29, 37-40).[3]

The Tax Court sustained the Commissioner's determination on the basis (a) of its conclusion that the sublease served no business purpose *of Plaza* and (b) of its inference that the transaction was motivated by prospective tax savings (R. 112, 116). The Court of Appeals affirmed, the majority opinion, written by Judge Frank, holding that the instant transaction, in that it reduced taxes and involved members of an intimate family group, was (R. 140)[4]

> "* * * a 'sham,' a 'disguise,' a 'masquerade,' a 'fiction,' a 'subterfuge,' a 'make-believe,' a 'mere pretense,' a 'mask,' a 'screen,' a 'veil,' an 'artifice,' a 'ruse,' or other names, supplied by the dictionary, * * *"

Chief Judge Swan, taking the contrary view in his dissent, stated (R. 143-144)[5]:

> "* * * The sublease created valid legal relations which the parties thereto intended should be carried out, and they were. * * * The present decision, at least by implication, seems to mean that once

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[3] The amount of Jeannette Brecher's earned income credit is one of the issues, the amount of the credit depending on whether her income is held to be dividends or earnings (R. 33, 117). Accordingly, it is necessary to associate Jeannette Brecher's case with that of Plaza in the instant petition.

[4] This language taken by the Second Circuit from its previous decision in *Kocin* v. *U. S.*, 187 F. 2d 707.

[5] We have refrained from arguing a point to which passing reference was made in the opinions of the Second Circuit below, namely, the question whether Jeannette Brecher's income could have been taxed to Leo Brecher, or to him and the other stockholders in proportion to their stock ownership. Respondent raised no such issue in the pleadings, and the evidence introduced was not calculated therefore to meet any such challenge. We suggest, however, that the income from an investment property such as an apartment house, hotel or theatre, after payment of expenses including the manager's compensation, belongs to the proprietor, not to the manager.

a man starts doing business in corporate form, he may not discontinue it and resume operations in his own name, or that of his nominee, so far as federal taxes are concerned. * * *"

Reasons for Granting the Writs.

This case presents a question of fundamental and continuing importance in the functioning of the tax laws: Whether property rights, created by an appropriate legal instrument, intended to be and, in fact, carried out and given substance by the conduct of the parties, may be disregarded as sham by respondent because the transaction creating such rights was between members of an intimate family group, a larger consideration might have been obtained in arm's length negotiations, and the effect was to save taxes. Implicit in the issue is the question whether taxpayers may conduct business in accordance with their own election or whether, having once chosen to do business as a corporation, they are precluded from changing back to individual operation.

In his dissenting opinion Chief Judge Swan stated that the case "goes further than previous decisions of the Tax Court" and carries too far "the rapacity of tax-gatherers." He also pointed out that the majority decision disregards what the parties intended and did.

The writs of certiorari should issue because the decision of the Second Circuit is in conflict with decisions of the other Circuit Courts of Appeal.

Aside from the conflict between the circuits, the issue is of particular administrative importance because the Tax Court, which handles the great bulk of all tax litigation, has now for several years, despite repeated reversals by

other circuit courts, continued to sustain respondent's disregard of legitimate transactions among related taxpayers where tax savings were effected. The problem is constantly arising and will continue to arise frequently. The situation is confusing and the conflicting decisions result in discrimination between taxpayers, the end result depending upon the circuit in which they happen to reside.

The decision below is inconsistent in principle, and probably in conflict, with the decisions of this Court.

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1. The decision below is in conflict with the decisions of the Fifth Circuit.[6] In *L. W. Tilden, Inc.* v. *Commissioner*, 192 F. 2d 704, reversing 9 TCM 219, a corporation which owned citrus groves executed a lease of its properties for a period of five years to be operated for the benefit of certain stockholders, all members of the Tilden family. The court emphasized that the corporation did not operate the properties, that the lessee had actually taken over such operation, and that the stockholders for whose account the lease had been executed had received large profits therefrom on which they had paid large taxes, and held that the income of the stockholders from the lessee's operation of the property could not be taxed to the lessor corporation, declaring (pp. 709, 710):

> "We are in complete disagreement with, and find clearly erroneous, the conclusion that what the parties did to realize this result was not a reality but a sham. * * *
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> * * * * * *
>
> In the family partnership cases, of which we have written many, one of the most recent being Batman

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[6] The conflict between the Second Circuit's decision herein and the decisions of the Fifth and Ninth Circuits is the subject of an article entitled "Second Circuit Would Penalize Change of Business Form" in the "Taxation Report" of the Research Institute of America, March 27, 1952 issue.

> *v.* Commissioner, 189 F. 2d 107, supporting the point by reference to, and discussion of, authorities, we have carefully pointed out that family arrangements which have substance are just as effective as those made by persons not members of the family. * * *
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> * * * * * *
>
> We think it is the commissioner, not the taxpayer, who puts form above substance when he insists that these transactions fail simply because the Tildens took the course they did to, and they did, save large taxes and with these savings were able to protect the property from the mortgages."

Similarly, the decision below conflicts with *Henson* v. *Commissioner,* 174 F. 2d 846, CA-5, reversing 10 T. C. 491. There, a husband made a gift of his entire interest and ownership in a business to his wife. She employed him as manager of the business and was not normally consulted as to its operation. There, as here, the Tax Court sustained the Commissioner in his disregard of the manner in which the parties elected to carry on the business. Reversing the Tax Court, the Fifth Circuit held (pp. 847, 848) that since the wife had "the absolute right of control over both the property and the income derived therefrom which adheres in a valid and legal title," and since "there are no conditions attached which would enable him [the husband] to retain a legal dominion and control over the property," the income was taxable to the wife alone, and not to the husband.

In *Alexander* v. *Commissioner,* 194 F. 2d 921, reversing 9 TCM 356, the Fifth Circuit declared (pp. 923, 925):

> "If there is any one thing which emerges clearly from the confusion caused by the body of utterances

> and decisions, administrative and judicial, dealing with claimed family partnerships, leading up to and culminating in Commissioner *v.* Tower, 327 U. S. 280, and Lusthaus *v.* Commissioner, 327 U. S. 293, it is that instead of their being examined with an eye single to determining whether in law and in fact they were a reality or a sham, many of them were examined and dealt with with a gaze, focused too much upon the consequences, to the surtax, of recognizing them.
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> * * * * * *
>
> This source [of error] has been and is the failure, and sometimes the refusal, of commissioner and Tax Court to recognize and give effect to the difference, on the one hand, between tax evasion, the use of pretenses and forbidden devices to lessen or defeat taxes, and, on the other, tax avoidance, the making of lawful, that is of bona fide and valid, dispositions and arrangements in respect to property and services, with the purpose and result of effecting legally permissible tax savings. Gregory *v.* Helvering, 293 U. S. 465, * * *"

Cf. Phillips, et al. v. *U. S.*, 193 F. 2d 132, CA-5, affirming unreported decision of the District Court, and *Britt* v. *Commissioner*, 190 F. 2d 946, CA-5, reversing 9 TCM 26.

2. The decision below is also in conflict with decisions of the Ninth Circuit. The result below was expressly predicated on the Tax Court's conclusion that the sublease was not in the "best interest" of Plaza because it did not afford Plaza as much profit as the Tax Court thought the circumstances warranted. In *Goold* v. *Commissioner*, 182 F. 2d 573, reversing 8 TCM 2, the Ninth Circuit considered a father's sale of a partnership interest to his son, for which the father received a $100,000 note, payable with-

out interest out of the son's share of future earnings, and stated (p. 575):

> "Under existing law, the father had complete freedom, at least up to the date of this writing, to transfer his property in any way he saw fit. So far as the disputed income tax deficiencies are concerned, whether or not the sale was an improvident transaction, is not of the business of the tax collector. The tax collector's apparent opinion that the father should not have sold valuable property to his son without a cash consideration, or that he should not have taken in payment a note payable out of future profits, is utterly immaterial."

The majority opinion below sought to distinguish the Ninth Circuit's decision in the *Goold* case on the ground that no finding of a motive of tax avoidance was involved. But in the later decision of the Ninth Circuit in *Twin Oaks Co.* v. *Commissioner*, 183 F. 2d 385,[1] reversing 8 TCM 280, that court, in the case of a partnership formed by the stockholders to take over the corporation's business and assets, excepting the real estate which the partnership leased, expressly held that a purpose of tax avoidance does not render a transaction sham, stating (p. 387):

> "It is * * * well settled that a taxpayer is free to adopt such legal organization for the conduct of his affairs as he may choose; he may convert from the corporate method to the partnership method of doing business and, though his motive in so doing be to reduce taxes, the conversion must be accorded recognition unless it is such a sham, such a change in form only, without substance, as to require that it be disregarded for tax purposes. Helvering *v.*

[1] This decision is referred to in the March 27, 1952 issue of the "Taxation Report" of the Research Institute of America as in conflict with the majority decision of the Second Circuit here.

> Clifford, 309 U. S. 331. * * * It seems clear to us, however, that the Tax Court, in its characterization of the change in business structure involved in the instant case as a sham and a mere form without substance, has, in effect denied the taxpayers the legal right to conduct their business affairs through a medium of their own choice."

3. Similarly, the decision below conflicts with the views of other circuit courts. The Tenth Circuit reversed the Tax Court for its refusal to recognize the form in which taxpayers elected to carry on business in *John L. Denning & Company, Inc.* v. *Commissioner*, 180 F. 2d 288, reversing 7 TCM 980. In that case, the wife, son and daughter of the taxpayer corporation's majority stockholder formed a partnership to carry on business formerly conducted by the corporation. The Commissioner taxed the income of the partnership to the corporation, and was sustained by the Tax Court. The Tenth Circuit reversed, holding that the income of the partnership belonged and was taxable to the partners and not to the corporation, and further, that Section 45 of the Internal Revenue Code did not authorize the Commissioner to attribute the partnership's income to the corporation, pointing out (p. 291):

> "* * * The holder of the majority of the stock in the corporation owned no interest in the partnership. The partners owned only a minority interest in the corporation. The earnings of the two entities were entirely separate and distinct. The earnings of the partnership arose from the capital, the credit, and the efforts of the partners. The income of the partnership belonged to the partners. Its income was clearly reflected by its records. There was no confusion of the income of the two entities which required any adjustment between them."

In the *Denning* case, where the facts were strikingly similar to those in the case at bar, the Tenth Circuit refused to permit the Commissioner, despite his having expressly invoked Section 45, to allocate *part* of the income or deductions of one taxpayer to a related taxpayer, while in the decision below the Second Circuit sustained the Commissioner in ignoring completely one of the related taxpayers and allocating *all* of her income to the other, without invoking that section. We submit that the views of the Tenth and Second Circuits are squarely in conflict. See also *Visintainer* v. *Commissioner*, 187 F. 2d 519, CA-10, reversing 13 T. C. 805, cert. denied 342 U. S. 858.

In *Greenberger* v. *Commissioner*, 177 F. 2d 990, reversing 7 TCM 346, the Seventh Circuit considered a partnership situation involving a taxpayer, his wife and three trusts for the benefit of their children. The Tax Court, in a decision by Judge Murdock who also decided the instant case, struck down the partnership for reasons similar to those assigned in his opinion in the instant proceeding. The Seventh Circuit, reversing, held that intent was controlling and that the dominant role of the husband in the partnership, plus the fact that the wife and trusts rendered no services, was not important, particularly in view of the fact the husband was paid a salary for his services. See, also, *Wellington* v. *Commissioner*, decided May 15, 1952, CA-7 (not yet officially reported but found in 1952 CCH Standard Tax Service, par. 9318), vacating and remanding 8 TCM 492 and 10 TCM 318, and *Skemp* v. *Commissioner*, 168 F. 2d 598, CA-7, reversing 8 T. C. 415.

In *Brown, et al.* v. *Commissioner*, 180 F. 2d 926, reversing 12 T. C. 1095, cert. denied 340 U. S. 814, the validity of lease agreements was in issue. The Tax Court, as in the instant case, refused to recognize the rights and interests thus created between related taxpayers, even though

the agreements were in fact carried out, and it denied deduction of the rent and royalty payments made pursuant thereto. The Third Circuit reversed, holding that the agreements were legally binding and might not be disregarded. See, also, *Funai* v. *Commissioner*, 181 F. 2d 890, CA-4, reversing 13 T. C. 696, and *Stanchfield* v. *Commissioner*, 191 F. 2d 826, CA-8, reversing 9 TCM 471. We note also that, in a case involving expenses, the Second Circuit recently upheld respondent's refusal to allow deductions among related taxpayers. *E. Field White* v. *Fitzpatrick*, 193 F. 2d 398, cert. denied April 21, 1952. Of course, respondent's power to determine what constitutes "ordinary and necessary" expenses has some basis in the statutes and differs materially therefore from his assumption of power here to attribute and tax the entire income of one person to another.

4. The question whether a transaction is sham because tax savings are thereby effected is important and constantly recurring. The need for correction of the Tax Court which continues to strike down transactions consummated in good faith is indicated by the frequency with which it has been necessary for the several circuits to reverse (some of the cases have been cited, *supra*). Since the Second Circuit supports the Tax Court's views on this issue, such correction may be brought about by granting certiorari in the instant proceedings.

Congress, recognizing the confusion created by respondent's determinations and the Tax Court's decisions, has partially remedied the situation in respect of family partnerships by the enactment of Section 340, Revenue Act of 1951, providing explicitly that interests in partnerships in which capital is material shall be recognized whether created by purchase or gift. However, since the legislation

does not purport to apply to 1950 and prior years and is restricted to family partnerships, it does not prevent respondent and the Tax Court from continuing, as in the instant case, to strike down family transactions, especially those not involving partnerships. Under these circumstances, we submit that this Court is the appropriate agency to effect such further correction as is necessary.

5. The decision below is probably in conflict, or at least inconsistent in principle, with this Court's decision in *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451.[8] The question in that case was whether the profit on sale of corporate assets by the stockholders after distributions in liquidation could be taxed to the corporation. Noting (p. 453) that "the Court of Claims found that the method by which the stockholders disposed of the properties was avowedly chosen in order to reduce taxes," this Court nevertheless held (p. 455):

> "• • • Whatever the motive and however relevant it may be in determining whether the transaction was real or a sham, sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax proposes."

6. The decision below misconstrues this Court's landmark decision in *Gregory* v. *Helvering*, 293 U. S. 465. The *Gregory* case is cited for the proposition that the income of Jeannette Brecher from the operation of the theatre

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[8] This conflict is noted in a recent tax publication criticizing the majority decision below (The Tax Barometer, issue of March 29, 1952):

> "• • • it concerns a basic question of tax law, is in conflict with other circuit court decisions, and is also at variance, at least in principle, with prior Supreme Court decisions, (for example, see Cumberland Public Service, 338 U. S. 451, • • •)."

under the sublease may be taxed to Plaza because the Tax Court found that the sublease was motivated by prospective tax savings. But the *Gregory* case does not hold that a transaction must be disregarded for tax purposes if it be motivated by tax savings. Indeed, in considering the question there involved, this Court (p. 469) expressly "putting aside * * * the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred," held only that on the facts there presented, no reorganization had actually taken place. The Court asserted (p. 469):

> "* * * The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

Similarly, see *United States* v. *Isham*, 17 Wall. 496, 506; *Superior Oil Co.* v. *Mississippi*, 280 U. S. 390, 395-396.

7. Although the instant case does not present a family partnership situation, it does involve a transaction between a wife and a closely held family corporation, in which her husband was the controlling stockholder. Hence, the principles formulated by this Court in *Commissioner* v. *Culbertson*, 337 U. S. 733, are pertinent, and should not have been ignored by the court below. In the *Culbertson* case this Court established (pp. 742, 743) that the validity of a family partnership depends upon whether, considering all the facts, including the "actual control of income and the purposes for which it is used," the parties had the "bona fide intent * * * to join together as partners." In the instant case it is not disputed that the parties intended Jeannette Brecher to conduct the business of operating the theatre for her own account as sublessee, which she did; moreover, the Tax

Court found as a fact that she received the net income as her own and used it without restriction for her own purposes.

The Tax Court's reference to the decisions in *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436, and *Higgins* v. *Smith*, 308 U. S. 473, confirms that it misinterprets the views of this Court; the opinion in the *Moline* case expressly stated (p. 439) that: "* * * the corporate form may be disregarded, *where it is a sham or unreal*" and held that the separate entity of the corporation must be accorded recognition under the facts of that case. (Italics ours.) This Court's refusal in the *Smith* case to recognize a loss from a sale by an individual to a corporation of which he was sole stockholder as lacking substance is a far cry from the refusal of the courts below to recognize Jeannette Brecher as the actual operator of the theatre pursuant to the sublease.

Conclusion.

In conclusion, and accepting fully the facts as found by the Tax Court, we submit that the Tax Court and the Second Circuit erred in regarding a transaction between members of an intimate family group as sham merely because the effect was to reduce taxes and arm's length standards in respect of consideration were not met. The correct view, reflected in the decisions of the other circuit courts and implicit in the decisions of this Court, is that such transactions must be respected taxwise if intended to be carried out and in fact consummated. The harshness of imposing on Plaza approximately $34,000 of taxes on $40,000 of income of its sublessee in addition to $17,000

of individual taxes already collected from the sublessee who received, kept and spent the income, requires no argument. The power to tax does indeed involve the power to destroy.[9] Respondent should not take the property of Plaza to pay taxes on income which it never received and to which it has no claim.

It may be asked why it is again necessary, after the many decided cases in which the circuit courts have clearly stated, consistent with principles recognized by this Court, that real transactions may not be disregarded taxwise, for this Court to review the instant case and restate the controlling principles. The answer is that the review sought herein is necessary because respondent and the Tax Court, so long as supported by the Second Circuit, will continue to limit the application of the broad underlying principle to special pattern situations such as family partnerships (as in the *Culbertson* case, *supra*), cases involving gifts, or cases of corporate distributions *in liquidation* (as in the *Cumberland Public Service Company* case, *supra*). The sharp division in the instant cases between the majority and minority views on what is real and what is sham, both views based on the same findings of fact, shows the need for further clarification. Admittedly, it is proper for respondent to scrutinize closely transactions between related taxpayers which reduce taxes, but this scrutiny should not be permitted to blind taxing officials to the real issue, i.e., whether a transaction is real or pretended.

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[9] It requires no clairvoyance to see the handwriting on the wall for Plaza should this Court fail to grant relief against respondent's asserted power to tax it on the earnings of its sublessee; its insolvency is assured, its destruction imminent.

WHEREFORE, your petitioners respectfully pray that writs of certiorari should be granted.

Respectfully submitted,

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May 27, 1952.

Appendix.

Internal Revenue Code.

Sec. 22. Gross Income.

"(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Sec. 45. Allocation of Income and Deductions.

"In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

(Sec. 45 before its amendment by Sec. 128(b) of the Revenue Act of 1943, effective January 1, 1944.)

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 91

58TH STREET PLAZA THEATRE, INC., and JEANNETTE BRECHER, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 106-118) are reported at 16 T.C. 469. The majority and dissenting opinions of the Court of Appeals (R. 139-144) are reported at 195 F. 2d 724.

JURISDICTION

The judgments of the Court of Appeals were entered on March 18, 1952. (R. 144, 145.) The petition for a writ of certiorari was filed on May

29, 1952. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's conclusion that the subleasing arrangement between taxpayer 58th Street Plaza Theatre, Inc., and taxpayer Jeannette Brecher had no business purpose and was but a family arrangement for distribution of income of the corporation to Jeannette Brecher and, accordingly, did not relieve the corporation of tax on the net profit derived from the operation of the theatre in 1943 under Jeannette Brecher's name.[1]

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or per-

[1] Subsidiary questions, not separately presented in the petition, are whether the court below erred in affirming the Tax Court's holding that the net profit received from the operation of the theatre by Jeannette Brecher, a stockholder of Plaza, is taxable to her as a dividend and whether taxpayer Jeannette Brecher is entitled to an earned income credit of $1,500.

sonal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

STATEMENT

The pertinent facts found by the Tax Court from a stipulation of facts, exhibits, and oral testimony (R. 108-112) are as follows:

Taxpayer 58th Street Plaza Theatre, Inc. (hereinafter called "Plaza"), is a corporation organized and existing under the laws of the State of New York. It used the accrual method of accounting. Taxpayer Jeannette Brecher is the wife of Leo Brecher. They filed their returns on a cash basis. For 1942 they filed a joint return and for 1943 individual returns. (R. 108.)

Leo Brecher has been engaged successfully for a long time in the motion picture industry as an exhibitor operating, owning or leasing motion picture theatres in New York and vicinity. He leased property on 58th Street near Madison Avenue in New York in 1929 and converted the existing stables on the property into a motion picture theatre, expending approximately $125,000 of his own funds for that purpose. He called it

the Plaza Theatre. The current lease runs for a term of 20 years commencing September 1, 1939. The rental is $30,000 a year, 15 percent of annual box office receipts in excess of $225,000, plus all taxes on the property in excess of $7,500 per annum. (R. 109.)

Plaza occupied and operated the theatre commencing September 1, 1939, under an oral agreement with Brecher for tenancy from month to month terminable at will. That arrangement continued until February 28, 1942, on which date Brecher sold the lease to Plaza for $200,000. (R. 110.)

On December 29, 1942, Brecher owned 1,050 shares, Jeannette Brecher owned 425 shares, their son owned 250 shares and their daughter owned 250 shares of the stock of Plaza. The children received their shares as gifts from Brecher. (R. 110.)

On December 29, 1942, Plaza subleased the theatre to taxpayer Jeannette Brecher for a term of five years commencing January 1, 1943, with provision for renewals. Under the sublease (Ex. 12-L) she was required to pay a fixed rental of $40,000, 15 percent of the amount by which the box office receipts exceeded $225,000 in each year, $15,000 per annum out of the profits from the operation of the theatre, and all taxes on the property in excess of $7,500 a year. The lessor could cancel the lease if less than $20,000 was paid

out of the profits in any two consecutive years. The owner of the property was not informed of the sublease. (R. 110-111.)

Jeannette Brecher opened a bank account in her registered trade name, "58th Street Plaza Theatre Company", through which she put the receipts and disbursements of the theatre. Brecher and Frank Schiffman, employed by Brecher, were authorized to draw checks on the account. Jeannette Brecher was issued a license by the City of New York to operate the theatre and the license previously issued to Plaza was cancelled. The insurance policies of the theatre were transferred to Jeannette Brecher. Contracts for films were entered into in her trade name after January 1, 1943, and she in other ways held herself out as operator of the theatre. (R. 111.)

Jeannette Brecher employed Brecher to manage the theatre for her during 1943 at a salary of $6,000 per year. She was present at the theatre on three or four days each week for periods varying from one to three hours. She paid the rent to Plaza for 1943 as required by the sublease. (R. 111.)

Jeannette Brecher reported a net profit from the operation of the theatre of $40,096.64 in her return for 1943. No part of that income was ever received by Brecher, directly or indirectly, and no part of it was used to discharge any of his obligations. Jeannette Brecher was not limited in any

way in the use of the income which she derived from the operation of the theatre. She used a large part to pay federal and state income taxes and used other parts for personal purposes. (R. 111.)

The Commissioner, in determining deficiencies, held that $40,396.34 was additional income of Plaza, on the ground that the sublease from Plaza to Jeannette Brecher did not constitute a bona fide transaction, and that $40,096.64 was taxable to her as a dividend from Plaza.[2] (R. 111-112.)

Jeannette Brecher gave 400 of her 425 shares of Plaza stock to her children on January 4, 1943. (R. 112.)

The box office receipts for the theatre ranged from a high of about $274,000 in 1931 to a low of about $146,000 in 1939. They amounted to about $180,000 in 1942 and to about $239,000 in 1943. The operating profit from the theatre ranged from a high of about $92,000 in 1931 to a low of about $2,800 in 1939. Plaza reported net income of $16,284 for 1942 from the operation of two theatres, of which Plaza was the more profitable. (R. 112.)

The sublease from Plaza to Jeannette Brecher, the Tax Court specifically found, served no business purpose of Plaza but was a family arrange-

[2] As the Tax Court stated (fn., R. 111), why the Commissioner included the extra $300 over the amount reported by Jeannette Brecher is not shown.

ment to give Jeannette Brecher increased income at the expense of Plaza and without payment of taxes thereon by Plaza. (R. 112.)

The Tax Court accordingly held that the 1943 net profits from the operation of the Plaza Theatre constituted taxable income of Plaza and, having been received by Jeannette Brecher, a stockholder of Plaza, were taxable to her as a dividend. (R. 114-117.) The Court of Appeals affirmed (R. 139-143), with one judge dissenting (R. 143-144).

ARGUMENT

Taxpayers incorrectly assert that the decision below presents an important question, is in conflict with a number of decisions of other Courts of Appeals, and is inconsistent in principle, and probably in conflict, with decisions of this Court. (Pet. 7-8.) The petition states no adequate ground for the granting of a writ of certiorari.

1. No important question is presented. The basic question is simply whether the subleasing transaction between the family-corporation taxpayer, Plaza, and taxpayer Jeannette Brecher, a stockholder, must be given effect for tax purposes. It is axiomatic that in tax law substance rather than form controls,[3] that family arrangements are particularly subject to careful scrutiny,[4] and that

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[3] See, e.g., *Higgins* v. *Smith*, 308 U.S. 473; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331.

[4] *Commissioner* v. *Tower*, 327 U.S. 280, 291; *Commissioner* v. *Culbertson*, 337 U.S. 733, 746.

a transaction or arrangement which is unreal or a sham may be disregarded.[5] The case therefore involves only an application of well-settled principles to the facts of the case. On the facts, both the Tax Court and the court below, the latter with one judge dissenting, regarded the subleasing transaction as unreal (R. 114-117, 140-143), the court below classifying it as an arrangement which can be called a sham or any one of a number of similar names (R. 140).[6] Taxpayers are incorrect in intimating (Pet. 14) that the court below held the arrangement to be a sham merely because it effected tax savings. The decision was based on all the facts and primarily upon the lack of a business purpose for a transaction which purported to be a business transaction. (See R. 140-141.) The decision below not only is correct, we submit, but presents a question which has no im-

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[5] See, e.g., *Higgins* v. *Smith, supra; Gregory* v. *Helvering*, 293 U.S. 465; *Bazley* v. *Commissioner*, 331 U.S. 737; *Stanwick's, Inc.* v. *Commissioner*, 15 T.C. 556, affirmed *per curiam* for reasons adequately stated in the opinion of the Tax Court, 190 F. 2d 84 (C.A. 4th); *W. H. Armston Co.* v. *Commissioner*, 188 F. 2d 531 (C.A. 5th); *Ingle Coal Corp.* v. *Commissioner*, 174 F. 2d 569 (C.A. 7th); *Limericks, Inc.* v. *Commissioner*, 165 F. 2d 483 (C.A. 5th); *Home Furniture Co.* v. *Commissioner*, 168 F. 2d 312 (C.A. 4th); *Palace Theatre* v. *United States*, 148 F. 2d 30 (C.A. 7th).

[6] The Tax Court specifically found as a fact that the subleasing arrangement served no business purpose of Plaza and was but a family arrangement to give Jeannette Brecher increased income at the expense of Plaza and without payment of taxes thereon by Plaza. (R. 112.)

portance in connection with other cases, which must necessarily be decided on their own facts.

2. The alleged conflict between the decision below and decisions and views of other circuits (Pet. 8-15) is non-existent.

The cases relied upon by taxpayer for a direct conflict are simply cases in which, with different facts, different results were reached. The present case involves a subleasing transaction, between a family corporation and one of the family stockholders, which was ostensibly a business transaction but which lacked a business purpose, was not an arm's length transaction, and was bad business for the corporation. Of the three decisions with which taxpayers allege the decision below is in conflict, only one involved a transaction between a corporation and a stockholder or stockholders. In *L. W. Tilden, Inc.* v. *Commissioner,* 192 F. 2d 704 (C. A. 5th), the taxpayer-corporation leased, for a fair rental, its citrus groves to a joint venture composed of stockholders. The Fifth Circuit stated that the corporation and its stockholders had a right to change the manner of operating the groves-"But any change must have a business and not merely a tax-saving purpose" (p. 708). The holding that the joint venture was real and not a sham rested primarily upon a conclusion that the joint venture was in accord with and carried out "the prime and unceasing purpose and intention which had dominated the Tilden

operations from the beginning", which was "to discharge the heavy indebtedness which had accumulated against the Tilden properties and to save them for their real owners, the members of the Tilden family" (p. 709). *Henson* v. *Commissioner,* 174 F. 2d 846 (C.A. 5th), involved a gift of a business from husband to wife, rather than a purported business transaction. *Goold* v. *Commissioner,* 182 F. 2d 573 (C.A. 9th), involved the question whether the income from a partnership interest was the taxpayer's separate property, taxable entirely to him, or was community property. It was his separate property only if he had received the partnership interest from his father by gift rather than by sale. The father had purported to make a sale of the partnership interest to him and there was in the case no tax avoidance purpose or other reason for holding that the purported sale was intended to be a gift.[7]

Taxpayers' assertion of a conflict between the

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[7] As taxpayers urge by citing and quoting other decisions (Pet. 9-11, 11-12), a tax avoidance motive does not *per se* require that a transaction be disregarded for tax purposes. The question is still whether the transaction has substance and reality. But in that connection the tax avoidance motive may properly be considered (*Commissioner* v. *Tower,* 327 U.S. 280, 288-289) and in some circumstances the lack of any other purpose, such as a business purpose in a business transaction, will reflect the lack of substance in the transaction. The converse may also be true; that is, as in the *Goold* case, *supra,* the lack of a tax avoidance motive may reflect bona fide intent.

decision below and the "views" of other circuits (Pet. 12-14) is also based upon cases which are factually distinguishable. In *John L. Denning & Co.* v. *Commissioner,* 180 F. 2d 288 (C.A. 10th), where a partnership was formed to carry on the same business which had been and continued to be carried on by a corporation, the question was whether the separate identity of the partnership should be recognized. The Tenth Circuit held that it should be, stating that the undisputed facts showed, among other things, that the partnership served an independent and legitimate business purpose. *Greenberger* v. *Commissioner,* 177 F. 2d 990 (C.A. 7th), held that a valid family partnership existed for tax purposes because the facts showed the good faith and legitimate purpose of the parties in forming the partnership. In *Brown* v. *Commissioner,* 180 F. 2d 926 (C.A. 3d), certiorari denied, 340 U.S. 814, the question, answered in the affirmative by the Third Circuit, was whether husband and wife, partners in a business, were entitled to business expense deductions for rents and royalties they paid as a result of their gift in trust and leaseback arrangement.[8]

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[8] The following cases, cited by taxpayers as "See also" cases (Pet. 13, 14), are all also distinguishable from the present case on their facts: *Visintainer* v. *Commissioner,* 187 F. 2d 519 (C.A. 10th), certiorari denied, 342 U.S. 858 (which involved a gift rather than a business transaction); *Wellington* v. *Commissioner* (C.A. 7th), decided May 13, 1952 (1952 P-H par. 72,443) (a family partnership case); *Skemp* v.

3. The decision below is not inconsistent or in conflict with *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451. What the Court held in that case was that a sale of corporate assets by the stockholders following a genuine liquidation and dissolution of the corporation would not be attributed to the corporation merely because of the stockholders' tax avoidance motive, Congress having chosen, for tax purposes, to recognize a distinction between a sale by the corporation and a sale by the stockholders following a genuine liquidation. Taxpayers apparently interpret the decision as holding that a tax avoidance motive may not be considered in connection with any tax situation or question. (See Pet. 15.) The decision does not so hold.

Taxpayers' assertion that the decision below misconstrues *Gregory* v. *Helvering*, 293 U.S. 465, is based on the erroneous assumption that the court below cited that decision "for the proposition that the income of Jeannette Brecher from the operation of the theatre under the sublease may be taxed to Plaza because the Tax Court found that the sublease was motivated by pros-

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Commissioner, 168 F. 2d 598 (C.A. 7th) (involving the question whether the taxpayer was entitled to a business expense deduction for rent paid pursuant to a gift and leaseback arrangement); *Funai* v. *Commissioner*, 181 F. 2d 890 (C.A. 4th) (a family partnership case); and *Stanchfield* v. *Commissioner*, 191 F. 2d 826 (C.A. 8th) (a family partnership case).

pective tax savings." (Pet. 15-16.) The Court below used the *Gregory* decision only as a general expression of the "applicable doctrine" that a purported business arrangement which serves no business purpose does not succeed as an insulator of the corporation from tax liability—that in keeping with the decisions such an arrangement may be treated as a sham. (R. 140.) It was that doctrine which the court below applied to the facts of the case, not, as taxpayers intimate (Pet. 16), the theory that a tax avoidance motive *per se* requires that a transaction be disregarded. In applying the doctrine, the court below considered not just taxpayers' tax avoidance motive but all of the other facts, notably, that there was no business purpose, that the subleasing transaction was not at arm's length, and that the transaction was bad business for the corporation. (See R. 141-142.)

CONCLUSION

The decision below is correct and involves no conflict of decisions or important question. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 91.

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58TH STREET PLAZA THEATRE, INC., and JEANNETTE BRECHER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING — PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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Petitioners,

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REHEARING—PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, 58th Street Plaza Theatre, Inc., and Jeannette Brecher, present this, their petition, for a rehearing of the above-entitled cause, and, upon such rehearing, respectfully request this Honorable Court to issue writs of certiorari to the United States Court of Appeals for the Second Circuit to review the decision and judgments of that court entered pursuant to the majority opinion affirming the decision and orders of The Tax Court of the United States. In support hereof, petitioners respectfully show:

I.

On May 29, 1952, petitioners filed a petition for writs of certiorari to the United States Court of Appeals for the Second Circuit, seeking review of the decision and judgments of that court entered on March 18, 1952, reported at 195 F. 2d 724, affirming 16 T. C. 469 (opinion by Judge Murdock, not reviewed by the court).

II.

Subsequent to the decision of the instant cause on February 27, 1951 by the Tax Court, and after the time in which to apply to that tribunal for rehearing or reconsideration had expired, another case involving the same question presented by the petition for writs of certiorari herein was considered by the Tax Court which then announced conclusions the exact opposite of those held controlling in this proceeding. *Coca-Cola Bottling Co. of Sacramento, Ltd., et al.* v. *Commissioner*, 17 T. C. 101, decided July 31, 1951. The latter decision was reviewed and approved, except for one dissent, by the full court.

III.

The issue in this proceeding is whether a split-off of business property must be in the best interests of the corporate transferor. The Tax Court found that a certain transfer (sublease) of a theatre by a closely held corporation to the wife of the majority stockholder was consummated, that the theatre business was carried on by or for the account of the transferee, and that the transferee received and used the net income for her own purposes. The trial

judge, however, applied the so-called "business purpose" doctrine and held that the transfer might be disregarded by respondent because it served no business purpose of the corporation.

IV.

In the *Coca-Cola Bottling Company* case, *supra*, the Tax Court considered the Commissioner's contention that a transfer (sublicense) by a closely held corporation to a partnership consisting of its two principal stockholders (husband and wife) served no business purpose of the corporation, that the partnership was therefore a sham, and that such transfer was merely a device for reallocating income among the family group with resulting tax advantage. There, however, the court pointed out that the parties intended to form the partnership to take over the business from the corporation and that the business was actually operated thereafter by the partnership. Accordingly, the court overruled the Commissioner, stating that a taxpayer has the right to adopt the type of organization which he prefers for the conduct of business.

V.

The facts in the *Coca-Cola* case closely parallel those in this proceeding; the issue involved is the same. As stated in the dissenting opinion of Judge Swan of the Second Circuit, the instant parties both intended and carried out the change from corporate to individual operation in accordance with the sublease, which created valid legal relations. Moreover, the Tax Court cited as authority for its conclusions in the *Coca-Cola* case, two of the very decisions of the Circuit Courts of Appeal which had reversed the

Tax Court's own earlier contrary decisions, promulgated while it was still maintaining, consistent with Judge Murdock's decision in this proceeding, that the Commissioner need not respect such transactions among related taxpayers. *Twin Oaks Co.* v. *Commissioner*, 183 F. 2d 385, CA-9, reversing 8 TCM 280; *John L. Denning & Co., Inc.* v. *Commissioner*, 180 F. 2d 288, CA-10, reversing 7 TCM 980.

VI.

Subsequent to the filing of the petition for writs of certiorari herein on May 29, 1952, and subsequent to the filing of the respondent's brief in opposition, the respondent formally acquiesced in the decision of the Tax Court in the *Coca-Cola Bottling Company* case, *supra* (Internal Revenue Bulletin of September 1, 1952, 1952-18-13908). By such acquiescence, respondent has accepted the decision as correct and has authorized administrative officials of the Bureau of Internal Revenue to apply the principles thus established in all other cases.

VII.

The instant petition for writs of certiorari was denied by this Court on October 13, 1952. However, now that the Tax Court, with only one dissenting judge, has reversed its position to accord with that of the great majority of the Circuit Courts of Appeal (the Second Circuit alone is squarely opposed), the instant case should be disposed of consistent with what is now the official view. Unless this Court acts, it will be impossible for petitioners to obtain the same treatment now concededly due to all taxpayers alike.

Wherefore, upon the foregoing grounds and in order that petitioners' cause may be disposed of in accordance

with the principles now formally acknowledged by respondent as correct, it is respectfully urged that this petition for a rehearing be granted, that the Court issue writs of certiorari to the United States Court of Appeals for the Second Circuit, and that, upon the issuance of such writs, the cause be reviewed by this Honorable Court, or remanded with instructions to the end that the decision and judgments shall be reviewed by the courts below and modified in conformity with principles now adopted by respondent for the administration of the revenue laws.

Respectfully submitted,

PAUL R. RUSSELL,
HOWARD D. PACK,
Counsel for Petitioners.

Certificate of Counsel.

We, counsel for the above-named petitioners, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

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